

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
RAIN BIRD **SPRINKLER** MFG. CORP., et al.)

Appearances:

For Appellants: Stanton P. **Belland**
 Philip C. Putnam
 Attorneys at Law

For Respondent: Kendall E. Kinyon
 Counsel

O P I N I O N

These appeals are made pursuant to section 26075, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Rain Bird Sprinkler Mfg. Corp. for refund of franchise tax in the amounts of **\$252,876.26** and **\$38,491.11** for the income years 1974 and 1975, respectively, and pursuant to section **25666** of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Anthony Manufacturing Corporation, et al., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Appeals of Rain Bird Sprinkler Mfg. Corp. et al.

<u>Appellants</u>	<u>Income Years Ended</u>	<u>Assessments</u>
Anthony Manufacturing Corp.	1975	\$35,130.00
Camsco Foundry, Inc.	1974	200.00
	1975	200.00
Clemar Manufacturing Corp.	197.5	200.00
Foothill Sales	1975	200.00
Glendora Mold & Die Corp.	1974	1,896.30
	1975	13,962.87
Leaserite, Inc.	7/31/74	104.20
	7/31/75	3,216.15
Lyntone Engineering, Inc.	1 9 7 5	22,576.14
Pacific Products, Inc.	1975.	200.00
Rain Bird National Sales Corp.	2/28/74	2,931.72
	2/28/75	2,031.39
Rain Bird Western Sales Corp.	1975	41,476.32
Sierra Screw Products	1975	200.00
Thermal Hydraulics Corp.	1974	200.00
	1975	200.00

There are two issues presented for decision. They are: (1) whether the notices of proposed assessment and computations of proposed overpayment issued by respondent satisfy the requirements of section 25662 of the Revenue and Taxation Code; and (2) whether unity of ownership exists if a group of corporations is owned by members of a family rather than by a single individual or entity.

Appellant Rain Bird Sprinkler Manufacturing Corporation was founded in 1946 by Mary E. La Fetra and her late husband, Clement La Fetra. Upon Clement La Fetra's death in 1963, his stock interest in the appellant group of corporations passed to his wife and two children, Anthony La Fetra and Sarah La Fetra Ludwick. By 1974, the number of corporations in which Mrs. La Fetra and her two children held a majority stock interest had expanded to 18. Of these 18 corporations, 17 were engaged in various phases of the manufacture and sale of sprinklers.

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

The corporations contributed to and were dependent upon other corporations owned by members of the La Fetra family. Because of the substantial unitary ties existing among the corporations, in 1975 respondent advised appellants that, based upon preliminary audit work, it appeared that the 17 corporations were engaged in a single unitary business. On the basis of respondent's letter, appellants filed a claim for refund for 1974 based upon combined report procedures and filed a combined refund return for income year 1975.

Following the filing of the refund claim for 1974 and refund return for 1975, respondent initiated an audit of the claim and return. Field audit work on the **claim** and refund return was performed during the latter part of 1976. At the conclusion of the field audit work, appellants' **representative** provided **respondent** with a position paper to support their contention that the corporations were engaged in a unitary business. **After** receipt of the position paper, by letter dated December 28, 1977, respondent requested additional information from appellants concerning the stock ownership of family members in **the corporations**. Appellants responded by letter dated March 3, 1978. This was followed by another letter from respondent dated September 14, 1978, requesting further information about family ownership and control. Appellants responded by letter dated October 16, 1978.

After it had completed its review of the material submitted by appellants, respondent sent appellants a letter on April 9, 1978, which advised appellants that respondent proposed to include only Rain Bird Sprinkler Manufacturing **Corporation**, Tri-Met Die Casters, Inc., Rain Bird of Europe, and Rain Bird International, Inc., in the 1974 combined report computation. Respondent further advised appellants that the combined report computation for 1975 would include the same four corporations plus Rain Bird National Sales Corporation. Respondent based this determination on the information that during 1974 and 1975, Mary E. La Fetra owned over 75 percent of the voting stock of Rain Bird Sprinkler Manufacturing Corporation. Rain Bird Sprinkler Manufacturing Corporation in turn owned more than 90 percent of the voting stock in Tri-Met Die Casters, Inc., Rain Bird of Europe and Rain Bird International Sales Corporation. **M a r y** **E.** La Fetra also owned more than a 75-percent voting stock interest in Rain Bird National Sales Corporation during 1975. Respondent included all of the corporations in which Mary E. La Fetra had a controlling stock interest in its computation of combined unitary income. Respondent

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

excluded corporations in which Sarah L. Ludwick, Mary La Fetra's adult daughter, owned more than a 50-percent stock interest. Respondent also excluded the remaining corporations proposed to be combined by appellants on the ground that no single person or entity owned more than a 50-percent voting stock interest during the years in issue.

On April 27, 1979, respondent issued "Notices of Computation of Proposed Overpayment" to Rain Bird Sprinkler Manufacturing Corporation for income years 1974 and 1975. The notices refer to attached schedules for unitary income and apportionment computations. The schedules include the four corporations named in the April 9 letter in the 1974 combined report computation. Rain Bird National Sales Corporation was added to the combined report computation for 1975. The notices also contain this explanation of the reason for adjustment to appellants' combined report computation: "Combination has been denied where the ownership requirement has not been satisfied." Also on April 27, 1979, respondent issued separate notices of proposed assessment to Anthony Manufacturing Corporation for income year 1975, Camsco Foundry, Inc., for income years 1974 and 1975, Clemar Manufacturing Corporation for income year 1975, Foothill Sales for income year 1975, Glendora Mold & Die Corporation for income years 1974 and 1975, Leaserite, Inc., for income years ended July 31, 1974 and 1975, Lyntone Engineering, Inc., for income year 1975, Pacific Products, Inc., for income year 1975, Rain Bird National Sales Corporation for income years ended February 1974 and 1975, Rain Bird Western Sales Corporation for income year 1975, Sierra Screw Products for income year 1975; and Thermal Hydraulics Corporation for income years 1974 and 1975. Each of the notices, **except**, the notices sent to Rain Bird National Sales **Corporation,**^{1/} contained the following explanation: "Combination has been denied where ownership requirement has not been satisfied." A calculation on the face of each notice showed that the proposed deficiencies were determined by multiplying the applicable rate times the separate net income originally reported for each corporation.

^{1/} The proposed assessment to Rain Bird National Sales Corporation included an adjustment based on additional facts which are not at issue in this appeal.

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

Within 90 days of the issuance of respondent's notices, appellant Rain Bird Sprinkler Manufacturing Corporation filed appeals from the denial of claims for income years 1974 and 1975. Each of the companies to which combination was denied filed a separate appeal from the proposed assessments. Because the issues of fact and law involved in each of the appeals are the same, we have granted the requests of appellants and respondent to consolidate the appeals.

Appellants first raise a procedural question. They claim that the notices issued by respondent did not adequately state the basis on which unitary status was denied, thereby denying appellants due process of law. The second issue is a substantive legal question. Appellants contend that majority ownership of a corporation can be held by a family rather than by a single individual or entity for unity of ownership to exist. Respondent contends that it is necessary for a single **individual** or entity to hold majority stock ownership. We will deal with the notice issue first.

Revenue and Taxation Code section 25662 provides as follows:

If the Franchise Tax Board determines that the tax disclosed by the original return is less than the tax disclosed by its examination it shall mail notice or notices to the taxpayer of the additional tax proposed to be assessed. Each notice shall set forth the reasons for the proposed additional assessment and the details of the computation thereof.

Thus, section **25662** requires each notice to state (1) the **reasons** for the proposed additional assessment, and (2) the details of the computation of the proposed assessment. Appellants argue that the notices were inadequate because they did not state the reasons that respondent determined that there was no unity of ownership.

In the Appeal of Paul A. Laymon Inc., decided by this board on October 6, 1976, we ruled that the term "reasons" used in the statute should be given its ordinary and familiar dictionary meaning of "an expression or statement offered as an explanation ... or as a justification of an act or procedure. . . ." We stated further that the reasons need not be detailed. The only details required by section **25662** are the details of the computations. We stated that the real issue is whether the

Appeals of Rain Bird Sprinkler-Mfg. Corp., et al.

reason given by respondent was sufficient to prevent any prejudice to appellant. In the present case we believe that it was.

The correspondence which preceded the notices and the statement, "Combination has been denied in those instances where the ownership requirement has not been satisfied," (Resp. Br. Exh. K), were sufficient to inform appellants of the reason for respondent's determination. Respondent's requests for information had centered specifically on details of family ownership of stock. Respondent's December 28, 1977, letter to appellants stated, "it was found that it is necessary to develop all data regarding ownership and activities of the family members in the operations of Rain Bird and the filing of the claims for refunds based on combination and family ownership" (Resp. Br. Exh. F). On March 3, 1978, appellants responded by giving details of the stockholdings of the La Fetra family. This response was followed by another letter from respondent requesting even more specific information concerning the stock interest; of the La Fetra family in the appellant corporations. Appellants' October 16, 1978, responses to this request indicated that no single person owned directly more than 50 percent of certain corporations which appellants had included in their combined report computation. Following receipt of appellants' October 16, 1978, letter, respondent sent a letter on April 9, 1979, to appellants. Stating respondent's final determination that Rain Bird Sprinkler Manufacturing Corporation, Tri-Met Die Casters, Inc., Rain Bird of Europe, and Rain Bird International, Inc., were entitled to file a combined report for each of the years 1974 and 1975. In the letter, respondent stated: "Because Mrs. La Fetra held ownership in excess of 50 percent of Rain Bird Sprinkler Mfg. Company, sufficient control is present to allow combination" (Resp. Br. Exh. J). The letter also stated that Rain Bird National Sales Corporation was included in the combined report for 1975 because more than 50-percent ownership control of the corporation was acquired by Mary E. La Fetra on December 31, 1974. Appellants' counsel confirmed receipt of this letter in appellants' stipulation of facts.

The notices and detailed computations, together with the preceding correspondence, were sufficient to enable appellants to make an intelligent protest. We find that the notices issued by respondent comply with the statutory notice requirement of section 25662.

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

We now turn to the issue concerning unity of ownership. When a taxpayer derives income from sources both within and without California, its California franchise tax liability is measured by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If a taxpayer is engaged in a single unitary business with affiliated corporations, its income attributable to California sources is determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).) The existence of a single unitary business is established by applying one of two tests. Under one test a business is unitary if there is unity of ownership, operation, and use. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), *affd.*, 315 U.S. 501 [86 L.Ed. 911] (1942).) Under the second test, a unitary business exists when the operation of the business done within California is dependent upon or contributes to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, *supra*, 30 Cal.2d at 481.) Implicit in this latter test is an ownership requirement. The only issue of dispute between the parties is whether the ownership requirement has been met. Respondent contends that to meet the requirement for unity of ownership, a single individual or entity must own more than 50 percent of the voting stock of each corporation to be included in the unitary group. Appellant argues that the ownership requirement is satisfied where the aggregate interests of several family members constitute more than 50 percent of the voting stock in the corporations.

In support of its position, appellant relies on the Appeal of Shaffer Rentals, Inc., decided by this board on September 14, 1970. In Shaffer Rentals, several members of one family owned part of the stock of two closely held family corporations. The remainder of the stock was held in trust for the benefit of other family members. Although the combined legal and beneficial interests of the family members constituted all the voting stock of the two corporations, no single individual or trust owned a majority interest in either corporation. Relying primarily on federal tax cases interpreting section 482 of the Internal Revenue Code, we held that the two corporations were owned or controlled by the same interests, and, therefore, unity of ownership was present. In the Appeal of Revere Copper and Brass Incorporated, decided by this board on July 26, 1977, we disapproved the analysis in Shaffer Rentals but not the result in the case.

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

Recently, however, we specifically overruled the decision in Shaffer Rentals and held that unity of ownership requires majority ownership by a single individual or entity. (Appeal of Douglas Furniture of California, Inc., Cal. St. Bd. of Equal., "Jan. 31, 1984.")

In the present case respondent included all of the corporations in which Mary E. La Fetra had a controlling stock interest in its computation of combined unitary income. Excluded from the combined reporting were corporations in which Sarah L. Ludwick owned more than 50-percent or in which no single person or entity owned more than a 50-percent voting stock interest. Based on the holding of Douglas Furniture, supra, we sustain respondent's action.

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in these proceedings, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Rain Bird Sprinkler Mfg. Corp. for refund of franchise tax in the amounts of **\$252,876.26** and **\$38,491.11** for the income years 1974 and 1975, respectively, and pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Anthony Manufacturing Corporation, et al., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

<u>Appellants</u>	<u>Income Years Ended</u>	<u>Assessments</u>
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be and the same is hereby sustained.

Appeals of Rain Bird Sprinkler Mfg. Corp., et al.

Done at Sacramento, California, this 27th day
of June , 1984, by the State Board of Equalization,
with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis
and Mr. Bennett present.

<u>Richard Nevins</u>	, Chairman
<u>'Ernest J. Dronenburg, Jr.</u>	, Member
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u></u>	, Member